UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

| | |
|---|---|
| San Diego Gas & Electric Company,<br><br>Complainant,<br><br>v.<br><br>Sellers of Energy and Ancillary Service Into Markets Operated by the California Independent System Operator Corporation and the California Power Exchange,<br><br>Respondents. | Docket No. EL00-95-031 |
| Investigation of Practices of the California Independent System Operator and the California Power Exchange | Docket Nos. EL00-98-030<br>EL00-98-033 |
| California Independent System Operator Corporation | Docket Nos. RT01-85-000<br>RT01-85-001 |
| Investigation of Wholesale Rates of Public Utility Sellers and Ancillary Services in the Western Systems Coordinating Council | Docket Nos. EL01-68-000<br>EL01-68-001 |

**COMMENTS OF THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

Pursuant to the Federal Energy Regulatory Commission's ("Commission") June 19, 2001, Order in the above-captioned dockets, *San Diego Gas & Electric Company, et al.*, 95 FERC ¶ 61,418 (2001) ("*June 19 Order*"), the Washington Utilities and Transportation Commission ("WUTC") submits these comments on the Commission's West-wide wholesale price mitigation plan for periods following the summer of 2001. Specifically, we recommend that the Commission:

A. Clarify the must-offer requirement for California generators to ensure that generation must be offered to Western System Coordinating Council ("WSCC") markets even if it is not needed by the California Independent System Operator ("CA ISO");

B. Include delivery costs in the mitigated price, or clarify that transmission costs and losses can be included in price-justification for sales above the mitigated price;

C. Establish the level of mitigated price for sales in the Northwest Power Pool sub-region of the WSCC based on natural gas prices in the Northwest;

D. Consider exemption from the mitigated price ceiling, or other separate treatment, for generation placed in service after June 19, 2001.

E. Consider replacing the California-determined price ceiling with a uniform, break-point cap for application across the WSCC;

In addition, we reiterate our previously made recommendations that:

F. The cost of power purchased by utilities in forward markets prior to June 19, 2001, to meet statutory load-serving obligations should be allowed to justify power later sold at a price that exceeds the ceiling price for short-term markets; and

G. Thermal generation that operates under air quality constraints that limit maximum annual hours of operation should be exempt from the "must-offer" requirement.

## I. INTRODUCTION

The *June 19 Order* establishes a mitigation plan for wholesale power prices in California and throughout western power markets covered by the WSCC. The plan is to be in effect for the period June 20, 2001, through September 30, 2002. The level of mitigated price is determined by the CA ISO based on a marginal cost generator located in California, operating at proxy delivered natural gas prices in California, under Stage 1 reserve emergencies declared by the CA ISO for its control area, which is located entirely in California.

The Commission developed the price mitigation plan principally to address well-documented problems in the California power markets. It extended the plan to the full WSCC, recognizing the interdependence and interconnection of power markets throughout the West with those inside California. However, the Commission further recognized the differences between California's circumstances and markets, and those existing in regions outside California. The Commission invited comments "for the purpose of revising the mitigation methodology for future periods, if necessary." *Id.* at 51. In particular, the Commission requested comments on "whether our approach is appropriate given regional differences between California and other regions." *Id.* at 51 n. 93.

The WUTC believes that the must-offer requirements and price mitigation plan, together with cooler temperatures, have served to moderate wholesale power prices in California and throughout the West so far this summer. As we move into winter, however, the WUTC is concerned that certain aspects of the plan: (1) may have unintended and adverse consequences for regions outside California, in particular the Pacific Northwest; and (2) that certain aspects of the plan treat load-serving utilities outside of California unfairly. We believe these consequences were unintended, and ironically, both of these possible adverse outcomes run counter to policies the Commission itself has advocated in response to power problems in the West. These unintended consequences can be averted by modifying the plan in a way that preserves the price supervision the WUTC continues to believe is important and necessary to ensure reasonable wholesale power prices.

## II. NAME AND IDENTITY OF COMMENTER

1. The name and address of the commenter:

Washington Utilities and Transportation Commission
1300 S Evergreen Park Drive SW
P.O. Box 47250
Olympia, WA 98504-7250

2. All correspondence, communications, and pleadings in this proceeding should be sent to each of the following:

Carole Washburn
Executive Secretary
Washington Utilities and Transportation Commission
1300 S Evergreen Park Drive SW
P.O. Box 47250
Olympia, WA 98504-7250

Robert D. Cedarbaum
Senior Counsel
Office of the Attorney General
1400 S Evergreen Park Drive SW
P.O. Box 40128
Olympia, WA 98504-0128

## III. INTEREST OF THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

3. The WUTC is an interested commission of the State of Washington, having jurisdiction to regulate the rates and charges for the sale of electricity to consumers within the state of Washington. The WUTC regulates the retail rates and charges of Puget Sound Energy, Avista Corporation, and PacifiCorp, all of which also buy and sell electric energy at wholesale prices in the WSCC, subject to regulation by the WUTC as public utilities.

4. Pursuant to Revised Code of Washington 80.01.075, the WUTC has authority to intervene before the Commission in proceedings in which there is at issue the rates or practices of utilities that affect the interests of the state of Washington, its businesses, and the general public. The Commission has granted the WUTC's motions to intervene in pending Dockets EL00-95-031, EL00-10-000, and EL01-68-000.

## IV. IMPLICATIONS OF THE PRICE MITIGATION PLAN FOR PACIFIC NORTHWEST ELECTRICITY SUPPLY

In comments made previously in these proceedings, the WUTC has recommended that price controls or mitigation be implemented with caution in order to accomplish necessary market stability, but not to discourage investment in generation needed to meet power loads. As the WUTC stated:

> Finally, we believe that the application of price controls must be done cautiously to avoid discouraging the construction of new generation capacity in the West. Price caps should be flexible enough to not preclude operation of expensive plants when they are needed to meet load, and set at a level low enough to provide stability without acting as a serious disincentive to new generation.

Motion of WUTC to Intervene in Docket No. EL00-10 at 23.

> Whatever approach is ultimately implemented must be simple, straightforward, and easy to understand. It must provide information about the rules and level of prices at which mitigation is to apply *before* transactions are made, not *after* the fact. We believe this is absolutely necessary to allow for informed market decisions and to ensure that the mitigation will serve to improve market stability.

Comments of WUTC on April 26 *Order Establishing Prospective Mitigation and Monitoring Plan for the California Wholesale Electric Markets and Establishing and Investigation of Public Utility Rates in Wholesale Western Electric Markets*, 95 FERC ¶ 61,115 (20001) at 20 (emphasis in original).

While we have yet to see how the Commission's mitigation plan performs during winter peaking conditions throughout the rest of the WSCC, we are concerned that tying the plan to California markets and circumstances will have adverse consequences and lead to greater market instability in regions outside California. While we would agree, and have ourselves argued, that the California and West-wide markets are interrelated, it is critically important to recognize that the marginal cost of electricity is determined in different regions of the West-wide market at different times of the year.[1] The Pacific Northwest is a winter peaking system. California and the Southwest are summer peaking systems. Also, transfer of energy south to north is subject to some level of transmission constraint.

---

[1] The Commission recognized differences among the western markets by stating, "In so doing, we were mindful that the West is a single market which is at once inextricably interrelated, yet characterized by important differences." *June 19 Order* at 2.

The Commission's mitigation plan establishes a price ceiling likely to be determined during California's summer peaks and applies that ceiling to other WSCC regions that face winter peaks, including the Pacific Northwest. This coming winter will be especially difficult in the Pacific Northwest because the region faces the lowest streamflow conditions on record. This means that production from our hydroelectric generation will be lower than average by several thousand megawatts. Given these extraordinary and unprecedented conditions, current projections show that, even after bringing on line all the generation and demand-side response we can hope for, the region will still face a 12 to 17 percent chance of supply shortfall.

After the Commission issued its *June 19 Order*, we witnessed statements in the press that several generation projects, particularly those aimed at providing emergency, short-term peaking capacity, have been discouraged because of uncertain cost-recovery under the mitigated price set in California this summer.[2] A number of parties highlighted this concern in petitions for rehearing of the *June 19 Order*. That such generation may not come on line would be an ironic result appearing to run at cross purposes to the extraordinary actions taken by the Commission to "help increase electric generation supply and delivery in the Western United States." *Order Removing Obstacles To Increased Electric Generation And Natural Gas Supply In The Western United States and Requesting Comments On Further Actions To Increase Energy Supply and Decrease Energy Consumption* ("*Order Removing Obstacles*"), 94 FERC ¶ 61,272 at 1 (March 14, 2001).

In view of the circumstances we have described, we are concerned that the "floating" price ceiling based exclusively on California conditions is inappropriate for the Pacific Northwest. It introduces a level of uncertainty that threatens to preclude the deployment of generation, particularly short-term, emergency peaking capacity that will be needed for the Pacific Northwest to meet load in the coming winter.

In addition, the WUTC notes that, while the must-offer requirements of the *June 19 Order* appear to have significantly increased the capacity available to the CA ISO to meet its loads this summer, that requirement may not help the rest of the WSCC this winter. The *June 19 Order* requires that "all public and non-public utilities who own or control generation in California must offer power in the ISO's spot markets." *Id*. at 8. The CA ISO operates both a control-area and a spot market. But the CA ISO's spot market is for generation necessary to meet *its* control-area obligations. The CA ISO's spot market is not a general market-place in which power is traded to meet the needs of other WSCC control-areas. Consequently, the requirement to sell available power to the CA ISO does not serve to ensure that available generation in California will be offered to meet the loads of control areas outside of California, particularly those in the Pacific Northwest this winter.

There is a limited amount of transmission capacity to move power from California north; the Pacific Northwest may need to import all that this capacity will permit in order to meet winter loads. Our experience prior to the must-offer requirement, where as much as 14,000 MW of California generating capacity was off-line, teaches us that in the absence of a requirement to offer power to control-areas outside California at the mitigated price, California generators may not be willing to export the power the region will need.

We believe that the Commission can remedy these problems in a manner that is both consistent with the spirit of the price mitigation plan and consistent with the Commission's objectives in the *Order Removing Obstacles*. We recommend specific modifications to the price

---

[2] *See* Mark Golden, "Small Generators Shut Down As FERC Price Controls Bite," Dow Jones

mitigation plan for the Commission's consideration. We are aware that other parties outside California also are recommending solutions to the problems we have identified.

## V. MODIFICATIONS TO THE PRICE MITIGATION PLAN TO ADDRESS PACIFIC NORTHWEST GENERATION SUPPLY ISSUES

### *A. Clarify the Must-Offer Requirement for California Generators to Ensure that Generation Must be Offered to WSCC Markets Even if It is Not Needed by the CA ISO.*

A West-wide must-offer requirement would ensure that California generation surplus to applicable native load and to contractual and reserve requirements will be offered to parties outside California. In the absence of such a requirement, this generation might not be offered at the mitigated price, or even at a higher price, because of the uncertainty of cost-recovery under the requirement for cost justification.

### *B. Include Delivery Costs in the Mitigated Price or Clarify that Transmission Costs and Losses Can be Included in Price-Justification for Sales Above the Mitigated Price.*

If the costs for delivering power to market-centers in the Northwest is not included, the mitigation plan could require sales at a loss even if the mitigated price properly reflects marginal generation costs. For example, transmission costs and losses for sales by California generators into Northwest markets can be substantial, perhaps similar in magnitude to the operation and maintenance adder included in the Commission's price mitigation formula.

### *C. Establish the Level of Mitigated Price for Sales in the Northwest Power Pool Sub-Region of the WSCC based on Natural Gas Prices in the Northwest.*

The Pacific Northwest relies on different gas supply regions and delivery points than does California. While the heat-rate of marginal plants in the Northwest is similar to the heat rate of marginal plants in California, the fuel-supply cost can differ substantially. Winter fuel-supply costs also will differ substantially from the natural gas prices used to set the mitigated price in California during the summer. At a minimum, the mitigated price in the Pacific

---

Newswire (July 13, 2001).

Northwest should reflect fuel costs in the Northwest when the transfer capacity on the Pacific Intertie is reached. Under this modification, the California and Northwest markets are separated because of the transmission constraint between them. Pricing points relevant for Northwest natural gas deliveries include Sumas, Stanfield, and Opal.

### *D. Consider Exemption from the Mitigated Price Ceiling, or other Separate Treatment, for Generation Placed in Service After June 19, 2001.*

The Commission should consider separate treatment under the price mitigation plan for generation placed in service after June 19, 2001. Such generation could be exempted from the mitigated price ceiling, or a soft-cap could be established based on the fully-allocated cost of temporary peaking generation. The WUTC offers these ideas as ways to avoid discouraging new generation, particularly short-term, emergency peaking generation, from being placed in service during the period of the price mitigation plan. We recognize that such modifications would add complexity to the plan and introduce some level of inequity by establishing vintages of generation. However, the current mitigation plan is only scheduled to be in effect for a year and such treatment would be consistent with the need for additional peaking capacity and with the extraordinary actions ordered by the Commission in the *Order Removing Obstacles*. If special treatment is provided for this category of generation, it should not extend to the must-offer requirement. The must-offer requirement should apply in order to ensure that this capacity is not withheld in order to maximize price.

### *E. Consider Replacing the California-Determined Price Ceiling with a Uniform, Break-Point Cap for Application Across the WSCC.*

The Commission included in its request for comments solicitation of "proposals concerning any alternative market mitigation approaches." *June 19 Order* at 46. We expect that several parties in the WSCC will recommend adoption of a $150, break-point cap to replace the floating cap determined by the CA ISO. Such a cap would be similar to the one originally adopted by Commission for the California markets in December 2000. *Order Directing Remedies for California Wholesale Electric Markets*, 93 FERC ¶ 61,294 (December 15, 2000). Application of this approach to the broader WSCC has both advantages and disadvantages. On the advantage side, a uniform, break-point cap is easier to understand, more straightforward, and provides for greater market certainty. It may better serve the Commission's stated principle:

> Buyers and sellers need certainty and closure. To the extent possible, our price mitigation should have clear rules, should set prices before they are charged and should not subject prices to change or adjustment after financial settlement of the day's transactions. Similarly, it should not rely on costly and time consuming administrative processes to set, adjust, or justify prices.

*June 19 Order* at 6.

On the disadvantage side, such a cap is decoupled from the mitigated price set in California, and this inconsistency could lead to arbitrage between the California and WSCC markets. We note that, while this is a disadvantage in theory, the marginal cost of power is not the same everywhere and at all times throughout the WSCC. The very problem we are addressing in these comments is caused by application of a single mitigated price determined in one sub-market to all sub-markets in the WSCC, which fails to recognize that there is diversity in marginal cost between markets and regions. A break-point cap high enough to include the marginal cost of generation in all of those sub-markets, yet low enough to act as a circuit-breaker protecting against unjust rates, may better achieve the objectives of market stability and certainty. The WUTC includes this alternative approach as one we believe the Commission should consider for WSCC-wide price mitigation. If the Commission adopts this alternative, it should also establish clear rules and procedures for establishing the cost evidence necessary to justify sales above the break-point cap.

## VI. IMPLICATIONS OF THE PRICE MITIGATION PLAN FOR LOAD-SERVING UTILITIES

In comments and filings previously made in these proceedings, the WUTC has argued that the bilateral markets in which power is traded in the Pacific Northwest are substantially different from the centralized, single-clearing price market in California. Moreover, we have pointed out that utilities fulfilling retail load-serving obligations in the Pacific Northwest heeded the admonitions of the Commission to reduce reliance on short-term markets and make longer-term power purchase commitments. In the face of the price mitigation plan, those utilities that purchased term-power prior to June 19, 2001, at prices elevated due to the dysfunction in the spot markets now face the prospect that they will have no opportunity to recover those elevated costs.[3] Even if supply situations in the Pacific Northwest are tight enough to justify market prices above the summertime California-determined price ceiling, sales of any surplus term-power may occur only at, or under, this mitigated price. The WUTC has argued that utilities that made such power purchases prior to June 19, 2001, should be allowed the opportunity to sell above the mitigated price, subject to price-justification based on their actual power purchase costs.[4] We reiterate that argument and our recommendation here.

### *F. The Cost Of Power Purchased By Utilities In Forward Markets Prior To June 19, 2001, To Meet Statutory Load-Serving Obligations Should Be Allowed To Justify Power Later Sold At A Price That Exceeds The Ceiling Price For Short-Term Markets.*

It is fundamentally unfair to preclude load-serving entities from the *opportunity* to recover in wholesale markets the cost of term products they purchased pursuant to load-service

[3] The Commission recognized the relationship between spot-market and forward-markets when it stated, "There is a critical interdependence among the prices in the ISO's organized spot markets, the prices in the bilateral spot markets in California and the rest of the West, and the prices in forward markets." *June 19 Order* at 5.

[4] Petition of the WUTC requesting Rehearing of the *June 19 Order*.

obligations incurred in those markets prior to the Commission's action to implement price mitigation. Load-serving utilities are fundamentally different from marketers because they do not have the choice to enter the market—they must obtain the power to serve their statutory obligations. Between December 15, 2001, and June 19, 2001, the Commission admonished purchasers in the wholesale power market to reduce reliance on spot or short-term markets and increase reliance on term products.[5] To ignore now the consequences of costs incurred by utilities that followed that advice would be to punish those that heeded the Commission's directives and, perversely, would benefit those that did not. Those that did not can now rely on mitigated prices in the short-term and spot markets.

This is a transition issue. We do not argue that power purchase costs incurred under term-contracts entered into subsequent to the price mitigation plan be used as cost justification. Now that the price mitigation plan is in effect, there is a connection between short-term and longer-term markets. However, with regard to term-transactions that span the periods before and after the Commission's implemented price mitigation, utilities are left with wholesale power costs they may be unable to recover. We do not argue that recovery of these costs should be guaranteed, only that utilities operating under a statutory, load-serving obligation should have the *opportunity* to recover their costs in the wholesale market if market conditions support prices above the level of the mitigated price.

---

[5] *San Diego Gas & Electric Co. et. al.,* Order Directing Remedies in California Wholesale Electric Markets, Docket No. EL00-95-000, et. al, 93 FERC ¶ 61,294 at slip. op. 29 (2000) (December 15th Order).

### G. *Thermal Generation That Operates Under Air Quality Constraints That Limit Maximum Annual Hours Of Operation Should Be Exempt From The "Must Offer" Requirement.*

Finally, the WUTC also argued in its petition for rehearing of the *June 19 Order* that the Commission should modify the must-offer requirement to clarify that thermal generation operated under air quality constraints by a utility with a statutory load-serving obligation is exempt from that requirement.

Specifically, we requested that the must-offer requirement be amended to provide an exemption if the generation is:

(a) Owned by utilities with load-serving obligations under state law; and
(b) Capacity necessary for the utility to ensure retail loads are met; and
(c) Operationally constrained by air quality or other exogenous regulatory factors; and

There exists:

(d) No practical option, such as a market for pollution credits to relieve the air quality or exogenous regulatory constraint.

We emphasize that these conditions would apply only to generation owned by load-serving utilities that dedicated the limited hours of allowed generator operation to serving the peak loads of their retail customers.

## VIII. CONCLUSION

The WUTC agrees with the Commission's principle providing that "[u]niform price mitigation for California and the balance of the West should reflect the same essential competitive market principles, while recognizing the significant differences in the structure of those markets." *June 19 Order at 6*. We appreciate the opportunity to offer comments focused on how the Commission's price mitigation plan may lead to unintended, adverse, and unfair consequences in the Pacific Northwest. In order to avoid those outcomes and in order to make the mitigation plan consistent with other policies and actions of the Commission, the WUTC urges the Commission to implement the recommendations it finds most appropriate among those we have described above.

DATED This 17th day of August, 2001.

Respectfully submitted,

______________________

Robert D. Cedarbaum
Assistant Attorney General
Counsel for the WUTC
1400 S. Evergreen Park Drive SW
Olympia, Washington 98504